

Before the
Federal Communications Commission
Washington, DC 20554

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Federal Communications Commission
Office of the Secretary

In the Matter of)	
)	
Petition of AT&T Inc. For Forbearance)	WC Docket No. 07-21
Under 47 U.S.C. § 160 From Enforcement)	
Of Certain of the Commission's Cost)	
Assignment Rules)	
)	
Petition of BellSouth Telecommunications,)	WC Docket No. 05-342
Inc. For Forbearance Under 47 U.S.C. § 160)	
From Enforcement of Certain of the)	
Commission's Cost Assignment Rules)	

PETITION FOR RECONSIDERATION

Sprint Nextel Corporation, AdHoc Telecommunications Users Committee, COMPTel, and Time Warner Telecom Inc. (together "Petitioners"), pursuant to 47 C.F.R. § 1.106 of the Commission's Rules, respectfully petition the Federal Communications Commission ("Commission") to reconsider its Memorandum Opinion and Order ("*Order*") granting the petition for forbearance from the Cost Assignment Rules filed by AT&T Inc. and BellSouth Telecommunications, Inc. (together "AT&T") in the above-referenced proceeding.¹

I. INTRODUCTION AND SUMMARY

The *Order* jeopardizes the Commission's ability to ensure that AT&T complies with its statutory and regulatory obligations, especially those under Sections 201(b), 202(a) and 254(k) of

¹ *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement Of Certain of the Commission's Cost Assignment Rules and Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, Memorandum Opinion and Order, WC Docket Nos. 07-21 and 05-342 (rel. April 24, 2008) (*Order*). The statutory provisions, Commission rules, and related reporting requirements from which AT&T seeks forbearance collectively will be referred to herein as the "Cost Assignment Rules." The data the Cost Assignment Rules generate will be referred to herein as "cost assignment data."

the Communications Act of 1934, as amended ("Act").² The *Order* is inconsistent with the standards set forth in Section 10 of the Act,³ and is arbitrary and capricious because it fails to explain its departure from past Commission and judicial precedent, fails to address arguments on the record, and is unsupported by record evidence.

The Act prohibits telecommunications carriers from imposing any charge or engaging in any practice that is unjust, unreasonable or unduly discriminatory.⁴ Because, as the Commission has consistently found, dominant carriers have the incentive and ability to use their market power to assess charges that generate monopoly returns and enforce anticompetitive service terms and conditions, it historically has adopted regulatory restrictions, pursuant to its Title II jurisdiction, that are designed to prevent dominant carriers such as AT&T from exercising market power.⁵ Implicit in Section 10 is the Congress' recognition that changing marketplace conditions over time may erode a dominant carrier's market power and permit the Commission to replace regulatory constraints on a carrier's conduct with marketplace forces.⁶ Section 10, however, bars the Commission from relaxing regulatory safeguards against dominant carrier abuses unless the carrier demonstrates that those restrictions are no longer necessary for the Commission to ensure that rates are just and reasonable and not unjustly or unreasonably discriminatory, to protect consumers, and to make certain that forbearance would be consistent with the public interest.⁷

² 47 U.S.C. §§ 201(b), 202(a), 254(k).

³ 47 U.S.C. § 160.

⁴ 47 U.S.C. §§ 201(b), 202(a).

⁵ *See, e.g., Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order*); *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) (*AT&T Price Cap Order*).

⁶ *See* 47 U.S.C. § 160.

⁷ *See* 47 U.S.C. § 160(a), (b). Section 10(a) of the Act permits forbearance only if the Commission determines that: (1) enforcement is not necessary to ensure that telecommunications rates are just and reasonable and not unjustly or unreasonably discriminatory; (2) enforcement is

In this case, the Commission erred in concluding that AT&T met this stringent statutory test, and thus cannot justify eliminating the Cost Assignment Rules based on the condition that AT&T develops its own accounting data compliance plan. The Cost Assignment Rules were developed to provide regulators and competitors with the information necessary to determine whether AT&T is exploiting its market dominance by imposing unjust, unreasonable and unduly discriminatory rates and by unlawfully misallocating costs. Eliminating those rules leaves a wide gap in the Commission's statutory oversight capabilities. Without the Cost Assignment Rules to help determine whether and how to recalibrate price caps as it has done in the past, the Commission can no longer be assured that price cap regulation will generate just and reasonable rates. Forbearance also eviscerates the effective operation of the new nonstructural safeguard framework established under the *Section 272 Sunset Order*, which is designed to protect consumers and competition from unlawful cost-shifting and anticompetitive pricing.⁸ The Commission explicitly found that the new nonstructural safeguards adopted in the *Section 272 Sunset Order* applied to AT&T.⁹ Furthermore, forbearance threatens the Commission's ability to ensure AT&T complies with Section 254(k)'s cross-subsidization prohibition.

The Commission candidly acknowledged all of these issues in the *Order*, and it therefore reaffirmed the need for Cost Assignment Rules. The *Order*, however, essentially attempts to

not necessary for the protection of consumers; and (3) forbearance is consistent with the public interest. 47 U.S.C. § 160(a). In reviewing the public interest prong, the Commission must consider whether forbearance will enhance competition. 47 U.S.C. § 160(b).

⁸ *In the Matters of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, *2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175, *Petition of AT&T for Forbearance Under 47 U.S.C. § 160(c) with Regard for In-Region, Interexchange Services*, WC Docket No. 06-120, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16556 (2007) ("*Section 272 Sunset Order*").

⁹ *Petition of AT&T for Forbearance Under 47 U.S.C. § 160(c) with Regard to Certain Dominant Carrier Regulations for In-Region, Interexchange Services*, Memorandum Opinion and Order, 22 FCC Rcd 16556 (2007) (*AT&T Interexchange Forbearance Order*).

finesse these shortcomings by requiring AT&T to preserve an accounting system that would provide data needed by the Commission. Rather than retain the regulations and adopt reforms necessary to update them, the Commission eliminated the Cost Assignment Rules as they apply to AT&T and then asked AT&T, the very firm whose incentive is to engage in cost misallocation the rules are supposed to constrain, to devise new rules.

The gap left open in the Commission's statutory oversight capabilities cannot possibly be filled by an AT&T-designed compliance plan. The *Order's* explanation of the compliance plan requirements is vague in form and substance, making its effectiveness questionable. In any event, AT&T, a carrier found to possess exclusionary market power, should not be in a position to fashion its own regulatory framework, but rather the Commission should design the plan to ensure it obtains the specific information it needs for its regulatory purposes. If the compliance plan does not provide the Commission ongoing access to the cost assignment data, then it will significantly reduce the ability of the Commission and third parties to obtain the precise data needed to detect violations, and to benchmark and evaluate the reasonableness of the data. If the accounting data produced under the compliance plan are not publicly accessible, it will make it more difficult for third parties to expose wrongdoing and file Section 208 formal complaints.

In sum, eliminating the Cost Assignment Rules and replacing them with an inadequate AT&T compliance plan eliminates safeguards on the front end and effective enforcement on the back end, leaving AT&T's market power to go unchecked to the detriment of consumers, competition and the public interest. Therefore, Section 10 and the Administrative Procedures Act ("APA")¹⁰ compel the Commission to reconsider and deny forbearance of the Cost Assignment Rules.

¹⁰ 5 U.S.C. §§ 551 *et seq.*

II. THE COMMISSION ERRED IN FINDING THAT FORBEARANCE FROM THE COST ASSIGNMENT RULES IS WARRANTED GIVEN THAT IT CONCLUDES THAT AT&T STILL WIELDS EXCLUSIONARY MARKET POWER.

The Commission designed the Cost Assignment Rules to reduce the likelihood that AT&T can exercise its exclusionary market power by: (1) charging its competitors in downstream retail markets unjust, unreasonable or unduly discriminatory rates for upstream inputs; or (2) unlawfully misallocating costs to the accounting categories associated with the upstream inputs over which AT&T has exclusive control. Given that competitive marketplace forces have yet to erode AT&T's dominance over bottleneck access facilities, the decision to grant AT&T's petition was premature. The Commission should reconsider its decision so that it retains the tools it needs to fulfill its statutory oversight responsibilities with respect to interstate access service rates, the detection and prevention of anti-competitive cost-shifting and pricing, and the foreclosure of the cross-subsidization prohibited under Section 254(k) of the Act.

A. The Commission Erred in Concluding That The Cost Assignment Rules Are Unnecessary to Assure that Price Cap Regulation Generates Just, Reasonable and Non-Discriminatory Rates.

As the Commission noted, price cap regulation is a transitional mechanism used to regulate rates until competitive market forces are sufficient to replace regulation.¹¹ In the *Order*, however, the Commission did not find that competition is such that the services currently under price caps can now be deregulated. This is unsurprising as AT&T filed absolutely no evidence on this point. While price caps remain necessary to constrain AT&T's prices, price cap regulation cannot automatically ensure just and reasonable rates if left on auto-pilot. This

¹¹ See *Special Access Rates for Price Cap Local Exchange Carriers, AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, 1998-99, ¶ 11 (2005) ("Price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.") (*Special Access NPRM*).

outcome is only possible if the price cap levels have been set correctly in the first place and are adjusted periodically to produce rates within the "zone of reasonableness."¹² Since the Cost Assignment Rules help identify malfunctioning price caps and serve as a benchmark to help reset them, they play a key role in ensuring that the price cap system yields just and reasonable rates. The Commission has observed in the recent past that price cap levels may be set too high for special access services.¹³ Yet the *Order* eliminates the very tools necessary to determine if that is the case. The *Order* fails to explain why the Commission's need for the data has now changed, and the unreasonably high rates of return obtained by AT&T and other dominant carriers shows that there is an urgent need to reform the existing price caps.

1. The Forbearance Condition Reaffirms that Price Cap Regulation Requires the Cost Assignment Rules.

In the *Order*, the Commission determined that the Cost Assignment Rules were unnecessary given that AT&T's interstate rates are regulated under price caps, rather than under rate of return regulation.¹⁴ The Commission reasoned that "price cap regulation severs the direct link between regulated costs and prices" thus reducing the incentive for a Bell Operating Company ("BOC") to shift non-regulated costs to regulated services.¹⁵ The Commission also maintained that reforms over the years have eliminated features of the original price cap regime that required rate of return regulation inputs.¹⁶ Recognizing that it has a continuing obligation under the Act, the Commission conditioned forbearance on AT&T providing "accounting data" at the Commission's request and implementing "a method of preserving the integrity – for both

¹² See *LEC Price Cap Order* at ¶ 3.

¹³ See, e.g., *Special Access NPRM* at ¶ 35 (noting "[i]n recent years, the BOCs have earned special access accounting rates of return substantially in excess of the prescribed 11.25 rate of return that applied to rate of return LECs").

¹⁴ *Order* at ¶ 16-17.

¹⁵ *Id.* at ¶ 17.

¹⁶ *Id.* at ¶ 19.

costs and revenues – of its accounting system in the absence of the Cost Assignment Rules to ensure that accounting data requested by the Commission in the future will be available and reliable.”¹⁷ It justified imposing this requirement based on a “strong connection” between this condition and its continuing responsibilities under the Act.¹⁸ The Commission also required AT&T to file a compliance plan explaining how it will satisfy this condition.¹⁹

The Commission cannot grant or deny forbearance based on possible, but undefined future regulatory mechanisms. If the Commission believes that the Cost Assignment Rules are in need of reform it should take steps to do so, not completely eliminate them. Considering the “strong connection” between the condition to maintain the data and the Commission’s statutory obligations, the Cost Assignment Rules are indeed necessary. Accordingly, Section 10 and the APA require the Commission to reconsider its decision and deny AT&T’s request for forbearance.

2. The Commission Has Required the Cost Assignment Rules to Adjust Price Caps in the Past.

It comes as no surprise that the Commission still needs the cost assignment data given that they have served and continue to serve as a critical regulatory tool. Since the inception of the price cap framework, the Commission recognized that “*cost, revenue, and demand data are essential to monitor LEC performance under price caps.*”²⁰ In the *LEC Price Cap Order*, the LECs alleged back then, as AT&T alleges today, that more detailed cost information was unnecessary for price cap regulation.²¹ Specifically, they claimed that rate level calculations based on rate of return were inappropriate in a price cap environment and would effectively stifle

¹⁷ *Id.* at ¶ 21.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *LEC Price Cap Order* at ¶ 380 (emphasis added).

²¹ *Id.* at ¶ 376.

the incentives the FCC sought to establish.²² The Commission, however, firmly rejected LEC claims and refused to reduce the level of relevant cost detail required. Alert to the danger of potential cost-shifting under price caps, the Commission found that undesirable state-interstate cost-shifting would be more difficult to detect if the data were more highly aggregated.²³ The Commission also found that “deletion from ARMIS of all category-level data would remove much of what is useful, and would considerably reduce the Commission’s ability to monitor LEC performance in a meaningful way.”²⁴ The elimination of the sharing requirement does not diminish the Commission’s findings that the Cost Assignment Rules are necessary for the Commission to monitor price cap performance and to preclude cost misallocation.

More recently, the Commission used cost data to uncover and help remedy price cap performance issues in the *CALLS Order*.²⁵ In the *CALLS Order*, which established the price indices to which AT&T is subject today, the Commission conducted an explicit review of carrier costs to determine the appropriate rate for various ILEC access services. The pricing reductions the Commission approved were targeted only at those price cap baskets with excessive rates of return, which were calculated using the very same cost assignment data the *Order* eliminated.²⁶ The Commission’s departure from this approach has not been rationally explained.

²² *Id.*

²³ *Id.* at ¶ 377.

²⁴ *Id.* at ¶ 378. “ARMIS” is the Commission’s Automated Reporting Management Information System.

²⁵ *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low Volume Long Distance Users; Federal-State Joint Board on Universal Service, Sixth Report and Order*, 15 FCC Rcd 12962 (2000) (*CALLS Order*).

²⁶ *See id.* at ¶ 171. The FCC targeted price reductions toward the baskets with the highest levels of rates of return. The effect was to reset the price cap index for those baskets at levels that were closer to the costs attributed to the services in the basket. This could only have been achieved by relying on the cost and revenue information ILECs maintain pursuant to the Part 69 rules and related ARMIS reports. *See id.* n. 376 (“Based on the 1999 ARMIS data, Commission staff

3. The Commission Needs the Cost Assignment Rules to Recalibrate the Price Cap Regime and Evaluate Other Regulatory Reforms Going Forward.

The Commission is simply wrong in finding that a vague future compliance plan is sufficient to find that AT&T met the Section 10 forbearance standard. The Commission's ongoing obligation to monitor the price cap system and to ensure it yields just and reasonable and not unduly discriminatory results renders the Commission's need for the Cost Assignment Rules today and into the future *certain*, not speculative. In fact, price caps are woefully overdue for recalibration. Price caps have not been adjusted since the *CALLS Order* and are generating rates that far exceed the "zone of reasonableness."²⁷ Since *CALLS* expired three years ago, the Commission was supposed to reexamine its price cap plan, a process which the Commission has started, but not yet completed. Recalibration will require the Commission to determine what price indices yield reasonable earning levels in the current market. Cost assignment data will help the Commission pinpoint exactly where adjustments are needed as it did in the *CALLS Order* and help benchmark and calculate reasonable price cap levels.²⁸

The Cost Assignment Rules also are necessary to evaluate any price cap changes AT&T may seek based on exogenous costs.²⁹ The *Order's* only statement addressing this argument is that "AT&T concedes that 'should AT&T's forbearance petitions be granted, it will no longer

calculated approximate rates of return of 85 percent for the traffic sensitive basket, 20 percent for the trunking basket, and 15 percent for the common line basket.").

²⁷ See *LEC Price Cap Order* at ¶ 3.

²⁸ The Commission has long recognized that uniform cost assignment data reporting allows for useful comparisons to monitor LEC performance and decreases the costs associated with investigating challenged conduct directly. See, e.g., *Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control*, 14 FCC Rcd 14712, ¶¶ 133-4 (1999) (*Ameritech/SBC Order*). The Commission failed to address its departure from this and other precedents.

²⁹ Exogenous costs are generally costs an incumbent local exchange carrier ("ILEC") incurs due to administrative, legislative, or judicial action beyond an ILEC's control.

have any basis for seeking exogenous relief for investment reallocation”³⁰ The Commission’s dismissal of the exogenous adjustment argument considers only that AT&T would want to reflect increased costs in its price caps. The Commission’s analysis errs, however, because it ignores that there may be exogenous cost changes that would reflect decreased costs in AT&T’s price caps. Were that to occur, the lack of data would effectively prevent third parties from petitioning the Commission to adopt exogenous cost reductions to price caps.

Furthermore, under the price cap rules, there are exogenous changes for modifications made to both the Separations Manual and the split between regulated and non-regulated costs (which states now could require), which would constitute exogenous changes. These are two aspects of the very Cost Assignment Rules that the Commission has waived for AT&T that could produce upward or downward adjustments to price caps. Without these rules remaining in place, AT&T, the Commission, nor third parties could properly compute such exogenous changes.

In addition to price cap recalibration, the Commission and third parties currently are relying on the Cost Assignment Rules in other rate-related contexts. For example, the Commission and interested stakeholders depend on cost assignment data to evaluate whether the Commission should re-impose price cap regulation on ILEC special access services subject to Phase II pricing flexibility. In the Notice of Proposed Rulemaking in WC Docket No. 05-25, the Commission used cost assignment data to examine “the relationship between demand growth and growth in expenses and investment” to determine if ILECs had achieved economies of scope and scale that warrant examination of special access rates.³¹ The *Order*, however, eliminates the very tools necessary to determine whether price cap levels are set too high for special access

³⁰ *Order* at n. 71 (citing AT&T Reply at 11).

³¹ *Special Access NPRM* at ¶ 29.

services. Without the Cost Assignment Rules, the Commission and other interested parties will lose the ability to calculate ILEC special access rates of return, which provide evidence that exorbitant special access rates are unjust, unreasonable and unduly discriminatory and that insufficient competition actually exists to justify Phase II regulatory flexibility.³² Consequently, given that, as the Government Accountability Office confirmed, competitive alternatives for special access are practically nonexistent to discipline excessive special access rates, AT&T will have *carte blanche* ability to raise rates and exercise its market dominance unchecked.³³

Moreover, jurisdictional separations and intercarrier compensation reform efforts require the continued availability of cost assignment data. Currently, the Commission is considering extensive reform of the Part 36 jurisdictional separations rules, a component of the Cost Assignment Rules, which allocate costs between state and federal jurisdictions. In 2006, the Commission extended the jurisdictional separations freeze and issued a further notice of proposed rulemaking to consider additional reform of the jurisdictional separations process.³⁴ The Wireline Competition Bureau (“WCB”) Staff Report has recommended that any Part 36 changes be instituted in the context of the Separations Freeze FNPRM proceeding and noted that, “WCB staff concludes that *Part 36 remains necessary in the public interest . . .*”³⁵ In addition, the Commission’s comprehensive review and reform of the intercarrier compensation framework

³² Based on ARMIS data, in 2007, the two largest BOCs – AT&T and Verizon – achieved rates of return of 137.6% and 62.0%, respectively.

³³ Government Accountability Office (“GAO”) Report to the Chairman, Committee on Government Reform, House of Representatives, “*FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*,” November 2006 at 19.

³⁴ *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Order and Further Notice of Proposed Rulemaking, CC Docket No. 80-286, 21 FCC Rcd 5516 (2006) (*Separations Freeze FNPRM*).

³⁵ *Federal Communications Commission 2006 Biennial Regulatory Review, Wireline Competition Bureau Staff Report*, WC Docket No. 06-157, at 18 (rel. Feb. 14, 2007) (WCB Staff Report).

also requires cost assignment data to ensure that any new regime promotes a competitive telecommunications market.³⁶ In fact, proponents of the Missoula Plan relied heavily on separations and other cost assignment data to support their proposal.³⁷ Moreover, state regulators use cost assignment data extensively for a wide variety of state regulatory oversight functions, as thoroughly documented in the record of this proceeding. Accordingly, the Commission erred in failing to recognize that in the absence of competition, there is a current, vital need for the Cost Assignment Rules to discipline AT&T's market power and help ensure that its rates are just, reasonable and not unduly discriminatory.

B. Forbearance from the Cost Assignment Rules is Inconsistent with the *Section 272 Sunset Order*.

The *Order* is flatly inconsistent with the *Section 272 Sunset Order*. Without explaining its complete reversal of course, the Commission surprisingly concluded that eliminating the Cost Assignment Rules did not conflict with the requirements of the *Section 272 Sunset Order*. The Commission's finding defies logic and is arbitrary and capricious because it does not justify its change in policy adopted less than one year later.

³⁶ *2000 Biennial Regulatory Regime – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II, Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Rulemaking*, Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286; Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, 80-286, 16 FCC Rcd 19913, 19967-68, ¶¶ 148-149 (2001) (*Phase II Report and Order*) (“The Commission’s ability to monitor and evaluate local transport access rates would be greatly hindered if it could not identify and track local transport costs separately from switched access costs.”).

³⁷ See Missoula Intercarrier Compensation Plan at 107, attached to Letter from Tony Clark, North Dakota PSC Commissioner and Chair, NARUC Committee on Telecommunications; Ray Baum, Oregon PUC Commissioner and Chair, NARUC Task Force on Intercarrier Compensation; and Larry Landis, Indiana URC Commissioner and Vice-Chair, NARUC Task Force on Intercarrier Compensation, to Hon. Kevin J. Martin, Chairman, FCC, CC Docket No. 01-92 (filed July 24, 2006).

In the *Section 272 Sunset Order*, the Commission reaffirmed that each of the BOCs possess “[e]xclusionary market power within its respective regions by reason of its control over ... bottleneck access facilities.”³⁸ While the Commission eliminated the separate subsidiary requirement for in-region, long distance service, it created a new framework to protect consumers and competition from BOC exclusionary market power.³⁹ The new framework consists of: (1) continued application of pre-existing requirements; and (2) additional requirements. The pre-existing requirements expressly include “the Commission’s accounting and cost allocation rules and related reporting requirements . . .” (*i.e.*, the Cost Assignment Rules).⁴⁰ In particular, the Commission found that “the continued treatment of the costs of, and revenues from, the direct provision of in-region, long distance services as non-regulated for accounting purposes will provide an important protection against improper cost shifting by the BOCs and their independent LEC affiliates.”⁴¹ The Commission added that “[t]his accounting treatment also will address concerns of continued compliance with Section 254(k) of the Act, and will lessen the chance that costs associated with such services are inadvertently assigned to a local exchange or exchange access category.”⁴²

1. Forbearance Eviscerates the New Nonstructural Safeguard Framework the Commission Established Under the *Section 272 Sunset Order*.

The *Section 272 Sunset Order* expressly identifies the Cost Assignment Rules as an integral part of the new framework designed to protect consumers and competition from unlawful cost-shifting and anticompetitive pricing emanating from BOC exclusionary market

³⁸ *Section 272 Sunset Order* at ¶ 64.

³⁹ *See id.* at ¶¶ 84-5.

⁴⁰ *Id.* at ¶ 90.

⁴¹ *Id.* at ¶ 94.

⁴² *Id.*

power over local bottleneck access facilities.⁴³ The *Order*, however, fails to acknowledge that removing the Cost Assignment Rules essentially guts the new nonstructural safeguard framework and provides little analysis to justify its action. The only rationale the *Order* offers is that the *Section 272 Sunset Order* was “a rulemaking of general applicability” and “[t]hat rulemaking does not preclude us from granting forbearance to AT&T, and indeed, we conclude that section 10 compels us to modify the framework where, as here, the three prong statutory standard for forbearance is satisfied for AT&T.”⁴⁴ The *Order* neither cites any evidence nor provides any legal analysis demonstrating that AT&T no longer holds exclusionary market power thus warranting a change in the new *Section 272 Sunset Order* framework. If the Cost Assignment Rules are an essential component of this new framework designed to protect consumers and competition from unlawful misallocation and anticompetitive pricing, and market conditions have not changed, then Section 10 actually compels the Commission to *deny*, not grant, forbearance. Before it can grant AT&T forbearance, the Commission must either explain why the Cost Assignment Rules are not in fact “essential” to protect consumers and competition, as it found merely nine months ago in the *Section 272 Sunset Order*, or it must explain how market conditions have changed for AT&T in those same nine months sufficiently to justify its disparate treatment. Since the Commission has done neither of these things – and based on the record before it cannot – the Commission must reconsider and deny AT&T forbearance.

The *Order's* analysis also ignores the *AT&T Interexchange Forbearance Order*, which applies specifically to AT&T and, in fact, was released the very same day as the *Section 272*

⁴³ Overall, the Commission found that this new nonstructural safeguard framework “provide[d] substantial protection against anticompetitive discrimination and improper cost shifting by the BOCs . . .” and “address[ed] concerns regarding the incentives and ability of the BOCs and BOC independent incumbent LEC affiliates to use their pricing of access services, including special access services, to impede competition” *Id.* at ¶¶ 85, 105.

⁴⁴ *Order* at ¶ 27.

Sunset Order.⁴⁵ In the *AT&T Interexchange Forbearance Order*, “the Commission found that targeted safeguards and other continuing legal requirements relied upon in the *Section 272 Sunset Order* are needed to protect against the possible exercise of market power by AT&T and the other BOCs.”⁴⁶ Indeed, the Commission found that, “granting AT&T relief from dominant carrier regulation *different from or in addition to*, that granted in the *Section 272 Sunset Order* would be *inconsistent with the public interest* under section 10(a)(3).⁴⁷ Removing the Cost Assignment Rules from the new framework, however, does grant AT&T relief different from and in addition to what it granted AT&T in the *Section 272 Sunset Order* and therefore is inconsistent with the public interest. Since the Commission has not explained this reversal of its previous decision, Section 10 and the APA require it to reconsider and reject forbearance.

2. Unlike the Cost Assignment Rules, the Imputation Requirement Fails to Identify or Prevent Excessive Rates.

The Commission seems to try to provide reassurance by pointing out that AT&T must continue to comply with the imputation requirement under Section 273(e)(3) of the Act. The imputation requirement was included as one of the “additional requirements” in the *Section 272 Sunset Order* nonstructural safeguard framework. The Commission claims that it cannot justify maintaining overbroad Cost Assignment Rules when a more focused approach will ensure that AT&T satisfies the regulatory goals of Section 273(e)(3).⁴⁸

The imputation requirement, however, is no substitute for the Cost Assignment Rules. The imputation requirement only prohibits AT&T from charging itself less than it charges any other carrier to whom it sells access. While this may help diminish AT&T’s opportunity to

⁴⁵ *AT&T Interexchange Forbearance Order* at ¶¶ 1, 6-7.

⁴⁶ *Id.* at n. 28.

⁴⁷ *Id.* at ¶ 7 (emphasis added).

⁴⁸ *Order* at ¶ 28.

engage in price squeeze conduct (where AT&T's retail price to end users is less than the access charge it imposes on its competitors), it does nothing to demonstrate that prices are set at lawful levels. The Cost Assignment Rules, not the imputation requirement, are an important tool for determining whether existing access rates produce unreasonably high returns. Accordingly, the requirement that AT&T file a description of its imputation methodology in its compliance plan is no substitute for the protections that the Cost Assignment Rules afford.

In sum, there is no evidence in the record to dispute the Commission's original finding that AT&T still holds exclusionary market power over bottleneck access facilities, and the *Order's* forbearance conditions are too vague for the Commission to determine that the modified *Section 272 Sunset Order* framework will provide sufficient protection against cost misallocation, excessive rates and anticompetitive pricing. In light of the foregoing, the Commission's grant of forbearance in this case is arbitrary and capricious and contrary to the requirements of Section 10.

C. Forbearance Jeopardizes the Commission's Ability to Ensure AT&T's Compliance with Section 254(k).

The Commission should also reconsider the *Order's* finding that the Commission did not need the affiliate transactions rules (part of the Cost Assignment Rules) to ensure that AT&T complies with Section 254(k) of the Act.⁴⁹ Section 254(k) provides that, "[a] telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition."⁵⁰ The Commission reasoned that the affiliate transactions rules are no longer necessary given that AT&T remains subject to Section 254(k) and must now: (1) file an annual certification that it will comply with its obligations under Section 254(k); and (2)

⁴⁹ *Id.* at ¶ 30.

⁵⁰ 47 U.S.C. § 254(k).

maintain and provide any requested cost accounting information necessary to prove such compliance.⁵¹ The *Order* erred because its only rationale for sweeping away the affiliate transactions rules is that AT&T has satisfied the forbearance test, but it provides no facts or legal analysis indicating exactly how.

The affiliate transactions rules play a crucial role in ensuring BOC compliance with Section 254(k). The Commission has long recognized that BOCs, including those regulated under price caps like AT&T, have a powerful incentive to cross-subsidize unlawfully.⁵² Most recently, in the *Section 272 Sunset Order*, the Commission recognized that the

“continued treatment of the costs of, and revenues from, the direct provision of in-region, long distance services as nonregulated for accounting purposes will provide an important protection against improper cost shifting by the BOCs and their independent LEC affiliates. This accounting treatment also will address concerns of continued compliance with section 254(k) of the Act, and will lessen the chance that costs associated with such services are inadvertently assigned to a local exchange or exchange access category.”⁵³

As discussed above, the *AT&T Interexchange Forbearance Order* aptly demonstrates that the Commission found the critical need for the Cost Assignment Rules as applied to price cap carriers, including AT&T, remains undiminished. The *Order*, however, fails to explain its complete reversal from this recent past decision.

⁵¹ *Order* at ¶ 30.

⁵² See *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905, ¶ 10 (1996) (*Non-Accounting Safeguards Order*) (“If a BOC is regulated under . . . a price caps scheme that adjusts the X-factor periodically based on changes in industry productivity . . . it may have an incentive to allocate improperly to its regulated core business costs that would be properly attributable to its competitive ventures.”). BOCs have long engaged in this kind of conduct. For example, NYNEX entered into a consent decree with the Commission in 1990 arising out of a Commission investigation into NYNEX’s misallocation of costs to its regulated rate base. See *New York Tel. & Tel. Co., Consent Decree*, 5 FCC Rcd 5892 (1990), *affirmed New York State Dep’t of Law v. FCC*, 984 F.2d 1209 (D.C. Cir. 1993). Pursuant to that consent decree, NYNEX was required, among other things, to reduce its interstate rate base by \$35.5 million, the amount by which it had padded its rate base to reduce its rate of return.

⁵³ *Section 272 Sunset Order* at ¶ 94.

Given the vital importance of the Cost Assignment Rules to help preclude unlawful Section 254(k) cross-subsidization, a certification and a vague compliance condition are insufficient to safeguard consumers and the public interest. While it is true that smaller carriers may file an annual certification under Section 64.905(c) of the Commission's Rules, AT&T is in a different position altogether.⁵⁴ The carriers subject to Section 64.905(c) are nowhere near as large as AT&T is in terms of sheer size and geographical coverage, and thus it is reasonable that AT&T's regulatory compliance burden would be larger.⁵⁵ In addition, smaller carriers do not pose the same level of threat as AT&T to inflict great irreparable harm to consumers and to the market as a whole. A mere certification, therefore, is not an appropriate means to assure AT&T's compliance.

Moreover, the *Order* finds that the affiliate transactions rules are unnecessary to help prevent unlawful cross-subsidies under Section 254(k), yet in the same breath requires AT&T to "maintain and provide any requested cost accounting information necessary to prove such compliance" [with Section 254(k)].⁵⁶ Again, it appears that the Commission is trying to finesse its need for the same type of data that it required AT&T to maintain and provide under the Cost Assignment Rules. Since the Commission itself acknowledges that it still needs this information to ensure AT&T's compliance with Section 254(k) to protect consumers and the public interest, it could not find that forbearance was appropriate under Section 10.

⁵⁴ 47 C.F.R. § 64.905(c).

⁵⁵ See *In the Matter of 2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, CC Docket No. 00-199, et al., 16 FCC Rcd 19911 (2001), ¶¶ 191-2 (explaining that "mid-sized carriers have more limited resources than the larger companies and the cost of regulatory compliance may disproportionately impact these carriers").

⁵⁶ *Order* at ¶ 30.

III. THE COMMISSION CANNOT RELY ON THE COMPLIANCE PLAN TO SUBSTITUTE FOR THE COST ASSIGNMENT RULES.

The Commission granted AT&T forbearance from the Cost Assignment Rules only on the condition that AT&T files and receives approval of a compliance plan.⁵⁷ AT&T's compliance plan must include: a description of how AT&T will continue to fulfill its statutory and regulatory obligations, including those under sections 272(3)(3) and 254(k) of the Act, and the conditions of the Order; proposed procedures to ensure such compliance; a description of AT&T's imputation methodology; AT&T's first annual Section 254(k) compliance certification; a proposal for how it will maintain its accounting procedures and data in a manner that will allow it to provide useable information on a timely basis if requested by the Commission; and an explanation of the transition process.⁵⁸ The Commission essentially is attempting to obtain cost assignment data through an AT&T-designed compliance plan. Unlike the Cost Assignment Rules, however, the AT&T plan may fail to ensure just and reasonable rates, protect consumers and safeguard the public interest. If the Commission needs cost assignment data to perform its regulatory functions, it should deny forbearance, rather than letting AT&T self-regulate where its incentives are to propose an ineffective compliance plan.

A. The Compliance Plan Fails to Provide Clear Guidance.

Because the Commission needs cost data, the compliance plan is a poor substitute for the Cost Assignment Rules because it suffers from several fundamental flaws. For something so essential to the Commission's statutory oversight functions, the *Order* provides very little guidance on the compliance plan's specific form and substance. The *Order* sweeps away decades of regulation honed over the years to produce effective measures of cost, which help the

⁵⁷ *Id.* at ¶ 11 (concluding that the Section 10 forbearance test is only satisfied to the extent that AT&T complies with the conditions imposed).

⁵⁸ *Id.* at ¶ 31.

Commission ensure that AT&T's rates are just and reasonable and thwart AT&T from engaging in unlawful cross-subsidization. The Commission, however, supplants its sound regulations with a vague compliance plan. The description of the plan merely states that AT&T should preserve accounting procedures and data for use in enforcement and rulemaking proceedings, and should include Section 272(e)(3) and 254(k) compliance procedures, an imputation methodology and a transition plan.⁵⁹ The Commission fails to provide clear guidance about the type of specific information it wants, how it should be collected, under what circumstances it will be made available to the Commission, how it should be revised, and other key pieces of information.

B. At a Minimum, the Commission, Not AT&T, Should Design the Compliance Plan.

The Commission, not AT&T, should design the compliance plan. By allowing AT&T to dictate its own regulatory framework, the Commission is improperly relinquishing its regulatory responsibilities and transferring them to AT&T. Permitting AT&T to set the terms of its own compliance plan is essentially akin to letting the fox guard the hen house. AT&T's primary responsibility is to maximize its value for its shareholders, not to protect consumers, promote competition, and uphold the public interest as the Commission is required to do. AT&T's shareholder obligations combined with its exclusionary market power create a dangerously strong incentive to misrepresent the information or provide the information in a way that skews the results in its favor. If the Commission needs the data in some form, the Commission must design the plan itself – as indeed it already had in the very Cost Assignment Rules for which it has granted AT&T forbearance -- to ensure that it obtains exactly the information it needs when it needs it to perform its statutory and regulatory obligations. The stakes are too high and the resulting harm is too great for AT&T, a carrier wielding exclusionary market power, to regulate

⁵⁹ *Order* at ¶ 31.

itself. Furthermore, the Commission erred by failing to explain adequately this unusual policy shift allowing AT&T to self-regulate. The Commission, at a minimum, should reconsider its decision to allow AT&T to develop its own plan.⁶⁰

C. The Compliance Plan Approach Impedes Proper Enforcement by Both the Commission and Third Parties.

The compliance plan approach hampers the ability of both the Commission and third parties to enforce the Communications Act and the Commission's rules effectively. In the *Order*, the Commission maintains that its condition requiring AT&T to provide accounting data at the Commission's request includes requests, "for purposes of an enforcement action against AT&T, either a Commission investigation or a complaint proceeding under section 208."⁶¹ The Commission emphasizes that "[c]omplaints under section 208 will remain an important mechanism for enforcing the provisions of the Act."⁶² The removal of the Cost Assignment Rules, however, significantly reduces transparency and thus makes enforcement more difficult.

When the Commission removes regulations designed to prevent harm from occurring on the front end, it uses enforcement to ensure that, if harm does occur, it is detected, penalized, and discontinued on the back end. In this case, the Commission is removing the Cost Assignment Rules, which generate publicly accessible data that deter statutory and regulatory violations and help easily detect and substantiate violations should they occur. If the data that results from the compliance plan are not publicly available, the plan will fail to provide the Commission with

⁶⁰ See Letter from Thomas Jones and Mia Hayes of Willkie Farr & Gallagher, Attorneys for Time Warner Telecom Inc., Integra Telecom, Inc., and One Communications Corp.; Karen Reidy, Vice President, Regulatory Affairs, COMPTTEL; and Anna M. Gomez, Vice President, Government Affairs, Federal Regulatory, Sprint Nextel Corporation, to Dana Shaffer, Chief, Wireline Competition Bureau, WC Docket No. 07-21 (filed May 12, 2008) (*Compliance Plan Letter*).

⁶¹ *Order* at ¶ 22.

⁶² *Id.*

real-time information it needs to uncover violations.⁶³ How will the Commission know if there is a violation warranting an accounting data request if it does not have the accounting data to flag the violation in the first place? The Commission needs ongoing access to monitor and easily detect a violation, not “upon request” access. In addition, even if the Commission asks for and receives accounting data generated under AT&T’s compliance plan, it cannot ensure that the data are narrowly tailored or objective enough to satisfy the Commission’s regulatory purposes. Furthermore, the Commission will lose its ability to benchmark and evaluate the reasonableness of the data in comparison with past filings and trends and in comparison with similarly-situated carriers – a cornerstone of its efficient enforcement approach for years.⁶⁴ The Commission’s failure to provide sufficient rationale to justify its departure from its traditional approach is arbitrary and capricious, and therefore the Commission must reconsider its decision and deny forbearance.

The compliance plan approach also impedes meaningful enforcement by making it more difficult for third parties that believe AT&T is violating Sections 201 or 202 of the Act by charging unjust and unreasonable rates or engaging in unlawful cross-subsidization to file complaints under Section 208. Complaints are a key enforcement tool for the Commission, because third parties expand the eyes and ears of the Commission to detect violations. Contrary to the Commission’s belief, however, Section 208 complaints may no longer “continue to be a

⁶³ Petitioners do not believe the Order changed the public availability of the accounting data and procedures, but to the extent it is not made available we seek reconsideration of that aspect as well pursuant to the arguments above.

⁶⁴ See, e.g., *Ameritech/SBC Order*, ¶ 113 (“Absent the ability to benchmark among major independent incumbent LECs, this Commission and state regulators would have no choice but to engage in highly intrusive regulatory practices, such as investigating the challenged conduct directly and at substantial cost to make an assessment regarding its feasibility or reasonableness.”).

viable option for enforcing the provisions of the Act and the Commission's rules" once the compliance plan replaces the Cost Assignment Rules.⁶⁵

Unlike court litigation and administrative trial type hearings, Section 208 formal complaints are often resolved solely based on written pleadings. Section 1.721 of the Commission's rules requires complaints to include "a complete statement of facts which, if proven true, would constitute a violation," and proposed findings of fact, conclusions of law, and legal analysis relevant to the claims and arguments set forth in the complaint.⁶⁶ In addition, "all material facts must be supported . . . by relevant affidavits and documentation."⁶⁷ The rules expressly prohibit assertions based on information and belief unless made in good faith and supported by affidavit.⁶⁸ In cases where a Section 208 formal complaint is made challenging a rate under Section 201, the Commission has found that "it is well settled that the complainant bears the burden of establishing that a challenged rate is unreasonable."⁶⁹ The scope and method of discovery in a formal complaint proceeding is limited.⁷⁰ Therefore, it can be difficult to obtain information from the alleged violator through discovery, which it cannot obtain from another source.⁷¹ Accordingly, complaints must stand on their own and provide the factual basis for a decision on the merits. Without such facts, they may be denied.

⁶⁵ Order at ¶ 22.

⁶⁶ 47 C.F.R. § 1.721(a)(4)-(6).

⁶⁷ 47 C.F.R. § 1.721(a)(5).

⁶⁸ *Id.*

⁶⁹ *Sprint Communications Co. L.P., v. MGC Communications, Inc.*, 15 FCC Rcd 14027, ¶ 5 (2000) ("MGC").

⁷⁰ See 47 C.F.R. § 1.729.

⁷¹ See, e.g., *American Message Centers v. FCC*, 50 F.3d 35 (1995) (finding that the Commission did not abuse its discretion by denying AMC's motion to compel discovery to uncover specific instances of discrimination because the Act placed the burden of pleading and documenting a violation of the Act on AMC.)

Given that cost assignment data are publicly available via ARMIS, third parties can evaluate them on an ongoing basis and use them as objective evidence of unlawful conduct, such as price gouging or unlawful cross-subsidization, to support complaints. If the data resulting from the compliance plan are not publicly available, third parties will not have access to information necessary to detect potential violations.⁷² The resulting information asymmetry, which the Commission has consistently identified as a matter for concern, would decrease the chance of disclosure and thus may increase the danger of unlawful rates and anticompetitive conduct.⁷³ Moreover, completely cutting third parties off from access to cost assignment data would make it much more difficult for them to lodge such complaints, and even if they do, there is an increased danger of denial due to lack of sufficient data. Consequently, third parties directly affected by AT&T's anticompetitive conduct may be silenced, and the Commission would lose a valuable enforcement device in the process.⁷⁴ At the same time, the increasing numbers of statutory and regulatory violations that go undetected increase harm to consumers and the public interest. The Commission, however, provided no reasoned explanation for this departure from its policy of transparency.

In sum, replacing the Cost Assignment Rules with an inadequate compliance plan eliminates both upfront safeguards and effective enforcement, leaving AT&T's dominant market

⁷² See n. 63.

⁷³ See, e.g., *Non-Accounting Safeguards Order* at ¶¶ 242-3 (recognizing that competitor access to data regarding a BOC's compliance increases the likelihood that potential anticompetitive conduct can be detected and penalized); *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act, as amended To Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd 20543, ¶ 253 (1997); and *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd 18945, ¶ 32 (2003).

⁷⁴ The Commission's adoption of the *Compliance Plan Letter* proposal requiring AT&T to continue to make the information publicly available to third parties would allay this concern. See *Compliance Plan Letter* at 1-2.

power to go unchecked. Therefore, the *Order* violates the Section 10 and APA standards, requiring the Commission to reconsider and deny forbearance of the Cost Assignment Rules.

IV. CONCLUSION

The *Order's* grant of forbearance is flatly inconsistent with the Section 10 standards. Furthermore, the *Order* failed to explain adequately the Commission's departure from past precedent, was unsupported by record evidence, and failed to address arguments on the record. Finally, the compliance plan upon which the *Order* relies to justify granting forbearance is vague and relies too much upon AT&T to craft and file it. The Petitioners therefore respectfully urge the Commission to reconsider its decision in the *Order* and deny AT&T's petition for forbearance from the Cost Assignment Rules.

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